**Assignment:** Financial Statement Analysis

The analysis of financial statements is critical for determining the financial health of any organization. Financial statement analysis, however, demands a thorough understanding of accounting rules and principles; if the information on these statements is to be interpreted accurately, a firm knowledge of the uses and limitations of these statements is vital.

* **Address** each of the following points about financial statements and financial statement analysis
* + The major purposes of financial statements Financial statement analysis helps managers, investors and creditors interpret the financial statements.   
    The management (or decision makers) use financial statement analysis to make relevant changes to the company. As all statements use historical data, these information enable the decision makers to reflect on past performance of the company and make plans to increase the profitability and ultimately the shareholder's wealth of the company.   
    For instance, if the inventory turnover is low, managemnet may decide to decrease their volume of stock so as not to incur unnecessary warehousing costs.
  + The type of information financial statements provide Analyzing Financial Statements involves evaluating three characteristics of a company: its liquidity, its profitability, and its solvency.   
      
    Comparisons can be made on many basis, but the main three categories are:   
    1) Intracompany basis: This is where we compare an item or financial relationship within a company in the current year with the same item or relationship in one or more prior years.   
    2) Industry Averages: This basis compares an item or a financial relationship of a company with industry averages (or norms) published by financial ratings organizations such as Dun & Bradstreet or Standards & Poors.   
    3) Intercompany basis: This basis compares an item or financial relationship of one company with the same item or relationship in one or more competing companies.  The comparisons are made on the basis of the published financial statements of the individual companies.
  + The limitations of financial statements Limitations of Financial Statement Analysis include:   
      
    1) Estimates: Financial Statements contain numerous estimates; to the extent that these estimates are inaccurate, the financial ratios and percentages are inaccurate.   
    2) Cost: Traditional financial statements are based on cost, they are not adjusted for price changes.  Comparisons of unadjusted financial data from different periods maybe rendered invalid by significant inflation or deflation.   
    3) Alternative Accounting Methods: Companies vary in the generally accepted accounting principles they use.  Such Variations may hamper comparability.  Although the differences in accounting methods are often disclosed in the notes to the financial statements, adjusting the data to compensate for different methods is difficult, if not impossible in some cases.   
    4) Atypical Data:  Fiscal Years of different companies are different, some companies, for example prepare their financial statements during the low point in operating activities; hence certain account balances (Cash, Receivables, Payables, and inventories) may not be representative of the balances in the accounts during the year.   
    5) Diversification of Firms:  Many U.S. companies are so diversified that they cannot be classified with a certain industry.
  + The outside factors upon which the conclusions drawn from these statements are reliant
  + How items in common-size statements are presented in a common-size statement, you set total sales as the denominator and all other sources of income as a percentage of that number. Common-size statement is beneficial to use if you want to analyze two or more companies of differing size against each other.
  + How ratios in ratio analysis are computed and used
  + Why most financial analysts prefer ratio analysis to common-size statements

McLean, Robert A. (2003). Financial Management in Health Care Organizations (2nd ed.). Albany, NY: Delmar Publishers.